TESTIMONY OF A. R. WATTS

OF

THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DOCKET NO. 2004-178-E

IN RE: SOUTH CAROLINA ELECTRIC & GAS COMPANY - APPLICATION FOR ADJUSTMENTS IN THE COMPANY'S ELECTRIC RATES AND CHARGES

Q. WOULD YOU PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION?

A. A. R. Watts, 101 Executive Center Drive, Columbia, South Carolina. I am employed by the Public Service Commission of South Carolina, as Chief of Electric in the Utilities Department.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a B.S. Degree in Electrical Engineering from the University of South Carolina in Columbia in 1976. I was employed at that time by this Commission as a Utilities Engineer in the Electric Department and was promoted to Chief of the Electric Department in August 1981. I have been in my current position since October 1999. I have testified before this Commission in conjunction with fuel clause, complaint, territorial assignment, Siting Act, and general rate proceedings.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to summarize Staff's findings and recommendations as set forth in the Utilities Department portion of the Commission Staff Report including review of the Cost of Service Studies and the Pro Forma Adjustments. In addition, I reviewed the proposed changes to the Company's General Terms and Conditions as well as the new depreciation study.

Q. WHAT IS THE PURPOSE OF A COST OF SERVICE STUDY?

A. The Company owns and operates an electric system which primarily provides retail electric service to residential, small general, medium general, and large general service and street lighting customers as well as some service to wholesale customers. Each of these classes of customers receives varying types of service, and contributes different load characteristics to the system. The Cost of Service Study is designed to accomplish the reasonable apportionment of the Company's revenues, expenses and rate base items among the individual classes of customers and regulatory jurisdictions.

Q. WOULD YOU EXPLAIN THE BASIS FOR THE DEVELOPMENT OF THE COST OF SERVICE STUDY?

A. The major components utilized in the development of a fully distributed Cost of Service Study are functionalization, classification and allocation. Functionalization is the process of categorizing cost according to its function, which is either production, transmission or distribution. Classification is the division of these costs into the characteristics of the type of service they provide, namely customer, demand and energy. The allocation of these costs is based upon the incurrence of the customer, energy or demand costs by the individual classes.

Q. PLEASE DESCRIBE THE ALLOCATION METHODOLOGY USED BY THE COMPANY IN ITS COST OF SERVICE STUDIES.

A. The Company filed its studies based on a Summer Four Hour Coincident Peak Demand, which it has utilized since 1976 and which has been consistently approved by this Commission. Allocation factors for the demand related items are twofold. The coincident peak (CP) allocator was developed based on the system territorial peak demand between the hours of 2 p.m. and 6 p.m. on the territorial peak day, which occurred on Wednesday, July 9, 2003 at 5 p.m. This allocator was used for the allocation of production and transmission investments along with their demand related expenses. The noncoincident peak (NCP) allocator was developed by combining the noncoincident peak demands of each class whenever they occurred during the test year. This allocator was used for the allocation of demand related distribution investments and expenses. The energy related allocation factors were based on the annual kilowatt hour sales for the test year adjusted for system losses. The customer related factors were based on the number of customers in each respective class. In addition, costs that were identified as being attributable to a specific jurisdiction or class of customer were directly assigned to that category.

Staff concluded from our review that the methodology applied in constructing these cost of service studies continues to provide reasonable apportionment and allocation of the Company's revenues, operating expenses and rate base. A summary of the results of the cost studies utilizing the Company's adjustments and proposed revenue increase is shown on Utilities Department Exhibit No. 1. This Exhibit shows the rates and indexes of return for the Company's South Carolina electric retail operations and each class of service within the retail jurisdiction. Exhibit No. 2 shows these same categories of returns and indexes using Staff's proposed adjustments.

Q. WOULD YOU PLEASE EXPLAIN THE UTILITIES DEPARTMENT'S ADJUSTMENTS WHICH YOU FEEL ARE OF PARTICULAR NOTE THAT ARE CONTAINED IN THE UTILITIES DEPARTMENT PORTION OF THE COMMISSION STAFF REPORT?

A. Yes, there are several adjustments that are of particular note that the Utilities Department was either singularly or partially responsible for reviewing for this proceeding. In Staff Adjustment #5 the Company proposed an annualized adjustment to turbine operating and maintenance expense to account for increased costs most notably associated with the new combined cycle units at Urquhart and Jasper. The adjustment includes only specific major maintenance activities anticipated to occur during an eight-year cycle and will be performed by special labor force professionals comprised of outside staff personnel. The Company also proposes to compare the actual annual costs to the expense level and book any difference to regulatory asset or liability accounts which would be subject to further order of the Commission. Staff recognizes the fact that these essential activities will result in additional expenses, however due to more uncertainty associated with projections in the later part of the proposed eight-year cycle, I would recommend using an average of the initial four years with booking of the difference between actual costs and the level allowed in rates. In addition the Company should provide a report of these booked amounts at the end of three years in order to allow the Commission to review the results for any further action it finds appropriate.

Adjustment No. 18 represents the effect of the new depreciation rates based on the new depreciation study proposed by the Company. The new study was performed using standard property grouping procedures, service life, salvage value and remaining life techniques along with an examination and analysis of the Company's associated historical data as well as future expectations applicable to depreciable plant balances as of December 31, 2003. The new rates basically resulted from use of the straight line method and the remaining and average service life depreciation procedures. The study includes the effect of the extension of the service life of the VC Summer Nuclear Plant resulting from relicensing by the Nuclear Regulatory Commission as well as a composite rate of 4.00% for the Jasper facility. In addition the Company is requesting that in the future it be allowed to book depreciation expense based on the rates for the individual plant accounts as listed in the proposed study instead of on a composite basis as has previously been the case. Application of rates for individual plant accounts would appear to result in an even more precise accrual than using composites and should help to further minimize the risk of specific account amounts deviating excessively from actual experience. The study is based on sound logic and practices and I have furnished the resulting rates to the Audit Department.

Of special note is Staff Adjustment No. 21 which addresses the proposal by the Company to voluntarily eliminate a significant amount of expense from this case associated with the Remediation Project at the Saluda Dam. This Project and its concomitant costs are requirements mandated by the Federal Energy Regulatory Commission (FERC). The Company is proposing to use the Federal income tax credits generated from its synthetic fuel program to offset these costs, estimated to ultimately be around $270 million by Project completion, and thereby eliminate them from possible consideration as a liability for the retail ratepayers in this case. The Company's creative proposal in this instance has provided the parties and the Commission the opportunity to avoid having to grapple with a requested increase of even larger magnitude by some $30 plus million. Staff concurs with this Adjustment.

Staff Adjustment No. 23 is a modification to the Company's request to amortize its investment associated with its participation with Duke Power and Progress Energy Carolinas in the now defunct GridSouth Regional Transmission Organization (RTO) Project. The Project was in response to directives from the FERC mandating creation of regional transmission organizations. The FERC's policies concerning RTOs appear to be a moving target and even now continue to evolve. Staff does not oppose amortizing these expenses but would recommend a sharing of these costs between ratepayers and stockholders, in a manner similar to abandoned plant, by not including the unamortized portion in rate base.

Staff Adjustment No. 36 is necessary to reconcile various minor miscellaneous differences in the outputs of the Company's Per Book Cost of Service Study as compared to its Adjusted Study; these differences are due to changes in allocators resulting from pro forma adjustments and rounding.

Q. WOULD YOU PLEASE PROVIDE STAFF'S COMMENTS ON THE COMPANY'S PROPOSED CHANGES TO ITS GENERAL TERMS AND CONDITIONS?

A. Yes, Staff reviewed the Company's proposal to increase the reconnection fee from $15.00 to $25.00. Analysis of the cost and data provided indicates the expense incurred by the Company to perform this activity is in excess of the amount requested and therefore supports this increased level. The Company's calculation is based on an equal distribution of these activities between normal and overtime hours and resulted in an average cost of $39.21. Since the majority of these reconnections (estimated to be approximately 75%) are performed during normal business hours, I believe a corresponding weighting of the costs results in a more appropriate computation of $30.18. The most recent adjustment to the reconnection fee occurred in 1993. For customers who may have difficulty paying bills, the Company works with consumers on payment arrangements and does have programs and resources available that offer other alternatives to having service disconnected. If the cost associated with this expense is not borne by those customers responsible for the incurrence, this cost will be shifted to all customers which is contrary to cost causation allocation. In addition the Company is requesting modification to language in its *GENERAL TERMS AND CONDITIONS*, Section III, CONDITIONS OF SERVICE, Subsection K, Reconnection Charge, which would allow the imposition of the reconnection charge if Company personnel make the trip to reconnect but are thwarted as a result of actions taken by the customer. Although this scenario is possible and probably does occur, there was no specific information available to ascertain the frequency and corresponding severity or the financial impact of this proposal. Therefore, Staff is unable to support this change at this time.

The Company's requested addition of Section IV (D) 5 concerning nonresidential customer deposit requirements would allow the Company to collect a deposit if the customer's credit standing has deteriorated to a level of insecurity. The Company proposes to apply this to nonresidential customers, excluding sole proprietorships, where at least three of the prior twelve monthly billings equal or exceed $25,000. In addition, the Company proposes three specific financial alert conditions for which, if any one or more occur, the application of a deposit for that customer would be prompted. Deposit options may include cash, surety bond, letters of credit or guarantors. The Company further states it will give the affected customer 30 days notice prior to the due date of the deposit and would also notify the Office of Regulatory Staff at that time. The Company's reasoning is this will provide it with the opportunity to reduce and in some circumstances eliminate uncollectibles and resulting write-offs which become the burden of the remainder of the ratepayers. The Commission recently approved a similar proposal for Duke Power on an experimental one year basis by Order No. 2004-417, dated October 1, 2004 in Docket No. 2004-167-E. Approval of the Company's recommendation in this instance would also require the waiver of Commission Regulation 103-331 (A) which establishes the criteria for a customer deposit.

Q. WOULD YOU PROVIDE STAFF'S COMMENTS ON THE COMPANY'S CHANGES TO THE LANGUAGE IN ITS ADJUSTMENT FOR FUEL COSTS TARIFF?

A. Yes, the Company inserted additional wording in two paragraphs of its Adjustment For Fuel Costs tariff to comply with and reflect the language in the latest version of the fuel cost statute. The addition to paragraph (B) tracks the latest language in SC Code Ann. Section 58-27-865(A)(2)(a) and the added language in paragraph (C) tracks that in Section 58-27-865(A)(2)(b). The language added to these two paragraphs is consistent with the statute with the exception of the omission in paragraph (C), of the words "including, but not limited to, transmission charges" when referring to economy purchases. This correction should be made to the Company's Fuel Cost tariff to accurately reflect the language in the statute.

Q. MR. WATTS, ARE YOU MAKING A RECOMMENDATION AS TO THE AMOUNT OF REVENUE THAT SHOULD BE APPROVED FOR SOUTH CAROLINA ELECTRIC AND GAS COMPANY IN THIS CASE?

A. No. I am not making any recommendation as to the amount of revenue which should be allowed in this proceeding.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.